

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0086
Adjusted Gross Income Tax
For Years 1999, 2000, 2001

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Adjusted Gross Income Tax—Agricultural losses

Authority: IC § 6-8.1-5-1(b); IC § 6-3-1-3.5; 45 IAC 15-5-3(8); 45 IAC 3.1-1-1 through 45 IAC 3.1-1-5 26 U.S.C. § 62; 26 U.S.C. § 165; 26 U.S.C. § 183

Taxpayers protest the denial of deductions from their adjusted gross income tax based on agricultural losses that the auditor decided were from a "hobby," not a business engaged in for profit.

STATEMENT OF FACTS

Taxpayers own two adjacent parcels of land totaling approximately 200-plus acres. The family home and taxpayers' operated convenience store are located on the land; taxpayers farm the remainder. Taxpayers suffered losses during the audit years at issue, which the auditor disallowed as deductions from taxpayers' individual income taxes. The auditor's rationale for disallowing the deductions was that taxpayers operated the farm as a "hobby." Additional facts will be added as necessary.

I. Individual Income Tax—Agricultural losses

DISCUSSION

Taxpayer protests the disallowance of deductions from adjusted gross income tax based on agricultural losses. The auditor's rationale for denying the deductions was based on the determination that taxpayers operated a "hobby" farm. In reality, the farmed acreage was devoted to the growing and selling of corn and soybeans for profit, as evidenced by documents taxpayer produced after the hearing.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a “notice of proposed assessment is prima facie evidence that the department’s claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made.”

The standards for sustaining a claim for deductions from adjusted gross income tax because of agricultural losses can be found at IC § 6-3-1-3.5 and 45 IAC 3.1-1-1 through 45 IAC 3.1-1-1-5. IC § 6-3-1-3.5 defines individual adjusted gross income tax in terms of Section 62 of the Internal Revenue Code, “modified as follows.” Section 62 begins with an individual’s gross income tax “minus the following deductions.” So, in order to arrive at an individual’s Indiana income tax liability, the Department looks at the federal adjusted gross income (gross income minus allowable deductions) and then modifies that figure according to IC § 6-3-1-3.5(a). One of the deductions allowable under the federal scheme is losses from the sale of property (section 62(a)(3)) which references sections 161 *et seq.* Section 161 provides that “there shall be allowed as deductions the items specified in this part,” i.e., Part VI. Section 165 allows deductions for losses “incurred in any transaction entered into for profit;” (165(c)(2)); section 167 allows deductions for depreciation of property used in a trade or business. Taxpayers ascribe their loss deductions as depreciation and interest, claiming that their income from their agricultural activities will rise as the depreciation and interest deductions lessen over time.

The auditor disallowed the deductions, arguing that since taxpayers operated the farm as a “hobby” and not for profit under section 165(c)(2) and section 183, taxpayers were not entitled to the deductions under Indiana’s tax laws. Section 183 disallows deductions for activities not engaged in for profit. Section 183(d) creates a presumption that if income exceeds deductions for three of five consecutive years, then the activity is engaged in for profit. The auditor applied section 183(d) in order to characterize taxpayers’ agricultural activities as a hobby because it showed no profit yet. It should be noted that taxpayers entered the acreage at issue into a federal conservation reserve plan, qualified, and received payments from the federal government in 1999, 2000, and 2001 for growing certain crops.

The Department finds that taxpayers have provided sufficient evidence to show that they are entitled to the deductions at issue.

FINDING

Taxpayers’ protest concerning the audit’s disallowance of deductions from adjusted gross income tax, based on agricultural losses, is granted.